



# MONTANA LEGISLATIVE BRANCH

## Legislative Fiscal Division

Room 110 Capitol Building \* P.O. Box 201711 \* Helena, MT 59620-1711 \* (406) 444-2986 \* FAX (406) 444-3036

Legislative Fiscal Analyst  
CLAYTON SCHENCK

DATE: February 21, 2008

TO: Legislative Finance Committee

FROM: Terry W. Johnson, Principal Fiscal Analyst

RE: Budget Growth Project/Graying of Montana

### PURPOSE

The purpose of this memo is to apprise the Legislative Finance Committee (LFC) of a proposed study by the Revenue and Transportation Interim Committee. This study, as discussed below, would address the same issues that would be covered by the "State Government Budget Model" and "The Graying of Montana" studies of the LFC. Since these studies would be duplicative, staff felt the LFC should be aware of the proposed study of the RTIC.

### BACKGROUND

At the beginning of 2008-09 interim, the LFC adopted two work plan items – State Government Budget Model study and The Graying of Montana study. Both studies were based on recommendations from Legislative Fiscal Division (LFD) staff. Because of several other significant projects, these studies were given a low priority for completion. Appendix A and B provides the background, study requirements, staff resources, and scope of project for each of these approved studies.

The RTIC was assigned an interim study (study taxation and school funding) that was contained in SJR 31. This study was in addition to two other assigned studies plus the regular workload of the committee. As the committee began its work on SJR 31, it became clear that data on the changing demographics in Montana was important information for a school funding study. Population trends not only impact the number of children attending public schools but also can affect the level of property taxes collected to fund public schools. The RTIC decided to solicit presentations from staff of the Center for the Rocky Mountain West and Montana State University, Agricultural Economics and Economics department. On December 6, 2007, the committee heard a presentation by Larry Swanson, Center for the Rocky Mountain West, on [Key Trends in Growth and Change in Montana](#). And on February 7, 2008, a subcommittee of the full RTIC heard a presentation by Myles Watts and Doug Young, MSU on [Population, Income, and Expenditures](#). Both of these presentations focused on the changing demographics that are anticipated in Montana beginning in year 2010 and continuing until at least 2030. The presentation by Dr. Watts and Dr. Young emphasized the significance of an

increasing elderly population in Montana, and its impact on state revenues and the cost of services provided.

The information provided in both presentations convinced the committee that a study was necessary to determine the impacts of an aging population in Montana. On Friday morning (February 8, 2008) the committee discussed the idea of contracting with staff at MSU to study the effects of changing demographic trends on Montana's revenue and expenditure bases. The study would cover the period from year 2010 to 2030. The chairman of the RTIC suggested the study be called "Project 2030". The RTIC voted unanimously to have Senators Peterson and Guillan pursue funding options and to coordinate a working focus group. Senators Peterson and Guillan are to present a proposal to the RTIC in April.

## **SUMMARY**

Since the studies of both LFC and RTIC appear to be duplicative, the LFC may want to discuss their options and provide further direction to staff. With the limited time left in the interim, the LFC may want to consider postponing any further action on these studies and wait until the RTIC comes up with a proposal. The LFC may also want to consider a partnership effort with RTIC on this initiative.

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## APPENDIX A

### STATE GOVERNMENT BUDGET MODEL

**Source/Authority:** LFD Staff Suggestion

**Background:** This particular project was undertaken during four years ago. Because of competing priorities and the significant amount of human resources required to do this project, a final product was not completed during the last interim. Although a final report was not produced, significant analysis was done on both state revenues and disbursements.

Many of state government services provided rely on the ability of the state's tax policy structure to raise sufficient revenues to provide those services. Public schools and higher education, human service programs, public safety, and many more services depend on state funds. Most of these funds are raised from taxes, fees, and investment earnings.

Unfortunately state revenues are not always stable and predictable. For example, during the late nineties, the gradual but significant increase in the equity markets contributed to unusual large increases in the state's revenue base. Since this occurred over a period of years, most state financial professionals felt these increases would continue into the future. Budget reductions, a special session, and a projected deficit of \$235 million proved this premise to be false.

Because Montana is required to balance its budget even during revenue turndowns, the state's budget may face a severe problem often referred to as a structural deficit or imbalance. In simple terms, this means the inability of state revenues to grow in tandem with the cost of providing governmental services

#### Study requirements

This project would require staff to do an in-depth review of both state revenues and disbursements. Considerable research and analysis would be required to identify and quantify data in order to answer the following questions:

- o What drives or determines the growth of state revenues?
- o What is the long-term trend in the growth of state revenues?
- o What drives or influences the growth of state disbursements?
- o What is the long-term trend in the growth of state disbursements?
- o Does the current state tax policy structure support the existing cost of providing governmental services?
- o What options are available to the legislature if the revenue base is or is not sufficient to support the level of existing services provide?

In actuality, some of this work has already been done.

**Staff resources:** This project will require significant staff time to research and analyze historical data relative to state revenue and disbursement growth patterns. For each revenue source and disbursement area, growth drivers or factors would need to be identified. Each factor would need to be extrapolated (trended) into the future to assess the cumulative affects on state revenues and disbursements. After the accumulation of this data, a conclusion could be determined. The

amount of additional staff resources would depend on the conclusion of the analysis. The development of options could be very time consuming and could be viewed as bias.

**Scope of project:** This project will include development of a historical financial database on state revenues and disbursements. An analysis of each revenue and disbursement category will be prepared with the objective to identify major factors that quantify growth patterns for the respective components. To the extent possible, identified growth drivers will be correlated with economic variables to provide the basis for long-term trending. A complete report will be prepared identifying and discussing major drivers, their relationship to economic conditions, option recommendations, and a summary conclusion. The conclusion will identify whether state revenues are sufficient to support the cost of providing existing services and what major factors contribute to state revenue and disbursement growth. As stated previously, identification of options to address the issue will depend on the results of the initial analysis.

**Proposal:** Staff will continue this project from what has been accomplished to date. The results of the analysis will be presented to the Legislative Finance Committee in October 2008, with updates at LFC meetings during the interim seeking LFC input.

## APPENDIX B

### THE GRAYING OF MONTANA

**Source/Authority:** LFD Staff Suggestion

**Background:** Montana is one of 10 states projected to have a higher number of persons over the age of 65 than school aged children by 2024. Within the next decade, U.S. census estimates project that 15 percent of Montana's population will be over 65, the 6<sup>th</sup> highest percentage in the U.S. This shift in demographics will have important ramifications for Montana state government.

State Revenue Impact - As the average age of the Montana population rises, there will be a proportionally higher number of taxpayers who are retired. The impact on state revenues may be a shift from reliance on wage and salary income to a greater reliance on transfer payments, capital gains, and other sources of investment and fixed income.

Consumption patterns of older persons are different than other age groups. Changes in consumption spending may also impact state revenue collections, but could be more pronounced within regional areas of the state.

There may be tax expenditures in the form of different types of tax exemptions for persons over the age of 65 that will impact state revenue.

State Appropriation Impact - As the Montana population ages, the types of state services desired by taxpayers may also change. There may be greater demand for services for the elderly, including Medicaid community, home-based, and nursing home services, prescription drug assistance, and other senior services. Medical costs for state institutions, including prisons, may increase also if the average age of the institutional population increases. There may be less demand, maybe even less public support, for education services and funding.

The medical workforce required to support an aging population might not be adequate unless current shortages are resolved. Additionally, the types of medical services needed for an aging population are different than a younger population and may not be readily accessible throughout the state. This change could impact the higher education system.

State Workforce Impact - Retirement of the baby boomer workforce could cause a system wide "brain drain" that may be significant if large numbers of persons retire within the same time span. Competition for replacement workers from a smaller labor pool may not result in the savings typically assumed when long-time employees retire and are replaced by new comers to state government employment. Additionally, retirees who opt to keep state employee health insurance may pose disproportionately higher costs for the state self-insurance pool due to extended life spans, and the current policy of charging retirees no more than the premium paid by active employees.<sup>1</sup>

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<sup>1</sup> The average benefit per retiree in the state group insurance pool is 135 percent of the cost of an active employee.

**Staff Resources:** This proposal would require a variety of LFD staff expertise and time to identify and evaluate the most significant impacts to state government due to an aging state population. Depending on the scope and number of impacts identified, the project could span more than one interim or the LFC may need to reduce the scope of the project and prioritize work issues.

**Proposal/Scope of Project:** The proposal and the scope of the project as outlined are the same, with the caveat that this initial list of issues would be refined and may expand. The following list includes the major issues that would be reviewed initially. Policy options that could be considered by the legislature will be identified and presented to the LFC as the research and evaluation proceeds. Preliminary topics include:

- o Evaluation of various demographic projections for Montana, including key indicators that could signal a change in projected trends
- o Identification of impacts to state revenue sources, including potential revenue changes that could be expected with a certain demographic change – eg a 1 percent proportional increase in the number of persons over 65 creates an estimated defined change in specific revenue sources
  - o Review of other states’ experience with property tax relief as persons age and property values increase
  - o Review Montana tax code with respect to taxation of persons over the age of 65
- o Identification of state expenditures related to an aging population and policy options:
  - o Non discretionary:
    - Health care entitlements (mostly some Medicaid services)
    - Projections related to a 1 percent proportional change in Montana population in persons over the age of 65
    - State institution medical costs
    - Personal services costs for state government
  - o Discretionary state spending:
    - Aging services such as Meals on Wheels, adult protective services
    - State prescription drug programs
- o Identification of workforce issues and potential legislative options including:
  - o Potential for a “brain drain” and contingency plans
  - o Reemployment options for retirees
  - o Financial soundness of retirement system
  - o Benefits and costs of early retirement incentives

**Coordination:** This study would complement the recommended study of a general fund budget model and would provide an in-depth analysis of one portion of the components of the larger study.